

Private foundations; taxable expenditures; scholarships to children of employees. A private foundation pays grants to an organization that is not a private foundation to provide scholarships only to children of a particular employer. The grants are grants to individuals under section 4945(d)(3) of the Code for which advance approval under section 4945(g)(1) is required, and are employer-related grants to which the guidelines of Rev. Proc. 76-47 apply.

#### ISSUE

Are the private foundation grants described below grants to individuals under section 4945(d)(3) of the Internal Revenue Code, for which advance approval under section 4945(g)(1) is required and to which the guidelines of Rev. Proc. 76-47, 1976-2 C.B. 670, are applicable or are they grants to an organization under section 4945(d)(4)?

#### FACTS

##### Situation 1.

Private Foundation X makes grants to Y to fund a number of scholarships for the college education of certain students evaluated by Y. Y is exempt from federal income tax under section 501(c)(3) of the Code and is not a private foundation under section 509(a)(1).

As part of a large independent scholarship program. Y evaluates all interested high school students according to its own criteria, which include performance on a qualifying examination, prior academic performance and potential leadership qualities, and recommendations from instructors. Applicants who achieve the highest rating based upon Y's criteria are classified as finalists. Y makes its own scholarship funds available only to such finalists.

X requires that its grants first be spent on behalf of children of employees of a particular company specified by X who are finalists as evaluated by Y. However, if the number of finalists from that company are too few to exhaust X's available grant funds Y will make such excess funds available as grants to the next most highly rated children of employees of the company even though they are not finalists.

##### Situation 2.

Private Foundation Z also makes grants to Y, the organization described above, Z's grants are made under the same circumstances described in Situation 1, except that Z's grant funds may be spent only for those children of employees of a particular company specified by Z who are finalists as evaluated by Y.

## LAW AND ANALYSIS

Section 4945(d)(3) of the Code provides that the term 'taxable expenditure' means any amount paid or incurred by a private foundation as a grant to an individual for travel, study or other similar purposes by such individual, unless such grant satisfies the requirements of section 4945(g).

Section 4945(d)(4) of the Code provides that a grant by a private foundation to an organization described in section 509(a)(1) is not a taxable expenditure.

Section 53.4945-4(a)(4)(i) of the Foundation Excise Tax Regulations provides that a grant by a private foundation to another organization, which the grantee organization uses to make payments to an individual for purposes described in section 4945(d)(3) of the Code, shall not be regarded as a grant by the private foundation to the individual grantee if the foundation does not earmark the use of the grant for any named individual and there does not exist in agreement, oral or written, whereby such grantor foundation may cause the selection of the individual grantee by the grantee organization. The regulation further provides that a grant shall not be regarded as a grant by the foundation to an individual grantee, even though such foundation has reason to believe that certain individuals would derive benefits from such grant, so long as the grantee organization exercises control, in fact, over the selection process and actually makes the selection 'completely independently' of the private foundation.

Section 53.4945-4(a)(4)(ii) of the regulations provides that a grant by a private foundation to an organization described in section 509(a)(1) of the Code, which the grantee organization uses to make payments to an individual for purposes described in section 4945(d)(3), shall not be regarded as a grant by the private foundation to the individual grantee (regardless of the application of section 53.4945-4(a)(4)(i)) if the grant is made for a project which is to be undertaken under the supervision of the section 509(a)(1) organization and such grantee organization controls the selection of the individual grantee. Section 53.4945-4(a)(4)(ii) will apply regardless of whether the name of the individual grantee was first proposed by the private foundation, but only if there is an objective manifestation of the section 509(a)(1) organization's control over the selection process, although the selection need not be made completely independently of the private foundation.

Section 53.4945-4(a)(4)(iv) of the regulations, which illustrates the operation of section 53.4945-4(a)(4)(i) through (iii), describes examples in which private foundations provide the funding for specific research projects carried out by individuals under the supervision of universities.

Section 4945(g)(1) of the Code provides that section 4945(d)(3) shall not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary, if it is demonstrated to the satisfaction of the Secretary that the grant constitutes a scholarship or fellowship grant which is subject to the provisions of section 117(a) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii).

Rev. Proc. 76-47, 1976-2 C.B. 670, provides guidelines for determining whether a private foundation's scholarship program that is employer-related satisfies the requirements of section 4945(g) of the Code.

Section 2 of Rev. Proc. 76-47 provides that an employer-related program is a program that treats children of some or all of the employees of a particular employer as a group from which grantees of some or all of the foundation's grants will be selected, limits the potential grantees for some or all of the foundation's grants to children of employees of a particular employer, or otherwise gives such children a preference or priority over others in being selected as grantees.

In both Situations 1 and 2, Y does not select the students who receive scholarships 'completely independently' of the grantors, X and Z. Both X and Z require Y to expend the grant funds only for the children of employees of the particular company specified by the grantor. As a result, Y is not, in fact, the grantee of the scholarships. Rather, Y merely functions as an evaluator for the grant programs of X and Z. Thus, the grant programs of X and Z are not within the scope of section 53.4945-4(a)(4)(i) of the regulations.

Also, in both Situations 1 and 2, the grant programs of X and Z are not within the scope of section 53.4945-4(a)(ii) of the regulations. The expenditures made by Y are not a project within the meaning of that section because they do not provide for Y to undertake or supervise any research or study as contemplated by that section. Additionally, there is no objective manifestation of Y's control over the process of selecting the students to receive the scholarships because both X and Z limit Y to considering only children of employees of the particular companies specified by X and Z rather than merely suggesting that such children be given consideration. As a result, Y is not, in fact, the grantee of the scholarships. Rather, Y merely functions as an evaluator for the grant programs of X and Z.

#### HOLDINGS

The grants described above are grants to individuals under section 4945(d)(3) of the Code for which advance approval under section 4945(g)(1) is required. Further, because the grants are limited to children of employees of a particular employer, they are employer-related grants to which the guidelines of Rev. Proc.

76-47 are applicable.

#### PROSPECTIVE APPLICATION

Pursuant to the authority contained in section 7805(b) of the Code, the conclusion of this revenue ruling will not be applied before March 8, 1982, to enable any private foundation participating in a scholarship program of the type described herein to obtain the necessary advance approval of its grant-making procedures as required by section 4945(g)(1) of the Code. If a private foundation fails to obtain advance approval of such a scholarship program within the time provided, any grants awarded and paid pursuant to such program subsequent to the effective date of this revenue ruling will constitute taxable expenditures subject to the taxes imposed by section 4945(a). However, the payment by a private foundation of a fix-sum grant awarded prior to March 8, 1982, but not paid until after March 8, 1981, will not constitute a taxable expenditure. See Rev. Rul. 81-46, 1981-6 I.R.B. 9.

See section 53.4945-4(d) of the regulations and Rev. Proc. 80-24, 1980-1 C.B. 658, for the applicable procedures to be followed in making a request for advance approval of grantmaking procedures.